



# Modern Capitalism: Enthusiasts, Opponents, and Reformers

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Modern Capitalism: Enthusiasts, Opponents, and Reformers

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Since its emergence in the late 1700s, modern capitalism has been the focus of intense controversy. On the one hand, capitalist economic growth has been extraordinary. On the other hand, capitalism has been prone to crisis, and is also associated with a striking degree of inequality. Much of the political controversy is driven by conflict between those who have gained or stand to gain from the rapid economic development of capitalism, and those whose fortunes are threatened by capitalist advance and cyclical crises.

On the positive side of the ledger is the extraordinary productive power that modern capitalism has unleashed, combining land, labor, capital, and human capital in ways that have increased output and income at a previously unimaginable pace. Even capitalism's severest critics recognized the great economic advances the system had wrought. As Marx and Engels wrote in the Communist Manifesto, capitalism "has created more massive and more colossal productive forces than have all preceding generations together." In the process, they wrote, capitalism had "rescued a considerable part of the population from the idiocy of rural life."

On the negative side is the undoubted fact that capitalist development can threaten the livelihoods of those who cannot compete with new technologies and new producers. Just as capitalism creates many winners, it also creates losers. Among these have been European craftsmen and farmers, undersold by new factory production and New World farming. The disaffected have also included countries in Latin America,

Africa, and Asia, whose production structures proved poorly suited – at least in the first instance – for international competition. And today there are many workers, small businesses, and others, who fear the market and political power of the large corporations that have come to dominate contemporary capitalism.

Another aspect of capitalism that has drawn criticism is its tendency toward periodic crises. This has been a feature of the system since its inception, and although governments seem to have developed more effective measures to mitigate the impact of crises, they certainly have not eliminated them. Critics of the capitalist order point with concern to the expectation that modern capitalist economies will intermittently hit the skids.

In what follows, we survey political responses to the development of capitalism since the late 1700s. Throughout, we focus on the two principal sides of the debate. Capitalism's principal supporters have been those who have benefited most from its development, or hope to do so. Capitalism's principal opponents have been those who have lost, or expect to lose, as the system progresses. In the middle, often, are reformers who want to salvage what is best about capitalism while smoothing some of its roughest edges. While it is impossible to do justice to every part of the globe, we try to cover both the advanced industrial countries – Europe, North America, Japan – as well as the poorer countries of Africa, Asia, and Latin America.

### **The mercantilist prelude**

Modern capitalism arose out of an international economic order in which Europeans dominated the rest of the world both economically and militarily. From the fifteenth to the eighteenth centuries, Europe's early-capitalist economies were governed by a mercantilist system that limited the operation of markets (see Patrick O'Brien on mercantilism, Volume 1: Chapter 12). These restrictions served to empower rulers, and to enrich or protect powerful economic interests. They were very successful at acquiring and exploiting colonial possessions for the benefit of the mother countries, and at channeling the energies of the budding capitalist societies toward the new manufacturing activities.

At the top of the European societies, the main champions of the mercantilist, early-capitalist, social order, apart from the rulers themselves, were the city-dwelling commercial and financial classes, principal beneficiaries of the systematic biases of economic activity. Governments at this early stage typically sanctioned monopolistic control over much economic activity, including overseas trade and access to colonial markets and resources. The monopolists – the Hudsons Bay Company and the Dutch East India Company, for example -- naturally backed the system. Some landowning elites gained from the new overseas opportunities – which many sent offspring to exploit. In addition, urban craftsmen and their guilds gained, for mercantilist restrictions on trade stimulated early local manufacturing by turning the terms of trade in favor of the mother country, especially by depressing the price of primary inputs and

raising the price of manufactured output. Given its combined military and economic goals, mercantilism was a striking success, associated with Western Europe's rise to global economic and military dominance. Yet it soon gave way to a more modern economic order.

### **The industrial revolution, 1770-1850**

*The rise of modern industrial capitalism.* Over the course of the 1700s, the new industrialism began to supplant the previous economic order in parts of northern Europe. Cottage industry and the "putting-out" system gave way to the factory system (see Harley on European industrialization, Volume 1: Chapter 14). Skilled craftsmen were replaced by water- and steam-powered machinery, which could be operated by less skilled workers, including children, and which required large amounts of capital. The result was an unprecedented increase in industrial output. But the extraordinary productivity of the new industries caused problems for many existing producers.

As the factory system thrived, it drove many of the earlier manufacturers out of business. Handloom weavers, on the Continent as in England, were first pressed by the putting-out system, then by Asian imports, and from the end of the Napoleonic Wars by textiles produced in the British factories that had leapt to the technical forefront. In many weaving-dominated regions, mass unemployment and actual starvation ensued, most notably in Silesia in the 1840s.

In the independent towns and principalities still dominated by guilds, the entry of capitalist modes of production and wider markets presaged a swift demise. The appearance on the European market of inexpensive mass-produced goods – textiles, shoes, apparel, toys, appliances – doomed traditional labor-intensive guild production. If the town admitted cheaper goods (even after paying high tariffs), the traditional craftspeople lost their customers. If mass-produced goods were excluded in an effort to preserve the local market, home-town consumers moved to areas that offered a greater variety of goods, services, and occupations, and again the traditional town withered.

Capitalism was more disruptive in many of the craft-based German towns than in England, France, Prussia, and the parts of Germany that the French had occupied under Napoleon, for there the guild system had already been abolished. These regions' petite bourgeoisie was correspondingly less tied to traditional manufacturing for everyday consumption and more to shop-keeping and highly specialized, often luxurious, decorative crafts (furniture, tapestries, jewelry, wine, glass). Even so, in some sectors, notably again spinning and weaving, the impact was catastrophic even in these more "enlightened" regions.

Whether in England or on the Continent, the expansion of modern industry – and something recognizably like modern capitalism – gave rise both to movements of enthusiastic supporters and to groups opposed to the new social system.

*Enthusiasts.* The new manufacturing interests were both the principal protagonists and the most fervent supporters of the new industrialism. The centers of the burgeoning factory system were to be found in the Midlands and the North of England, including such cities as Birmingham and Manchester; in parts of Northern France and Wallonia, and in the German states (chiefly Prussia).

Entrepreneurs in the new industrial centers quickly recognized that what Adam Smith called “the mean and malignant expedients of the mercantile system”<sup>1</sup> were impediments to the full development of modern manufacturing. Mercantilist monopolies restricted entry to new economic actors, even (or especially) when they were more efficient. Barriers and limits to overseas trade sometimes restricted access to promising foreign markets. Agricultural protection raised the cost of inputs, and – inasmuch as food was a major part of workers’ consumption basket – raised employers’ labor costs as well. Where modern industrial production took hold, so too did political movements to curtail or eliminate existing controls on the new economic activity.

In Great Britain, the main early incubator of the new industries, two great and interrelated political battles marked the political coming of modern capitalism. The first was the struggle to reform the country’s political system to give more representation to the “middle classes,” originally defined as those in between the aristocracy and the peasantry, especially the town-dwelling business and professional classes. The

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<sup>1</sup> Smith 1776, Book Four.

notoriously lopsided nature of British Parliamentary representation dramatically overweighted the countryside and underweighted the cities. Large landowners not only had their own house of Parliament, the House of Lords, but personally controlled many seats in the House of Commons by means of their influence over the so-called pocket boroughs. Neither Manchester nor Birmingham, by the 1830s cities of over 200,000 and 100,000 inhabitants respectively, had a parliamentary representative of its own, while there were dozens of districts (“boroughs”) with only a few score residents. The most notorious of the rotten boroughs, such as Old Sarum, had few if any inhabitants: none of the 11 voters in the 1831 election in that borough lived in the area.<sup>2</sup> Another, Durwich, was literally under water, the sea having encroached on almost all the land of what had once been a flourishing port town.

From the 1760s onward there were scattered attempts to expand the franchise and correct Parliamentary mal-apportionment, but – unsurprisingly – they received little support from sitting members of Parliament. The French Revolution hardened the opposition of those concerned that an enlarged franchise would only lead to that sort of catastrophe. But after 1815 pressures for reform grew, and the underrepresented regions roiled with protest and mass demonstrations, some of them met with violent repression. Perhaps even more importantly, the new elites of the manufacturing towns

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<sup>2</sup> The standard history of the period is still Woodward 1962, pages 25–30 and Book I, chap. 1. For a (much) fuller account, see Buttle 2011.

began to mobilize their wealth and influence on behalf of parliamentary reform.

Eventually, in 1832 Parliament passed a Reform Act that substantially expanded the franchise (to about five percent of the country's population), despite the continued opposition of many elite factions.<sup>3</sup>

Electoral reform, once enacted, provided the opportunity for the strongest business supporters of the new capitalism to make their voices heard more effectively, and they immediately set about attempting to affect policy along these lines. The new representatives of the industrial areas were especially concerned about one of the principal issues of the day, repeal of the Corn Laws. These were tariffs on grain, originally imposed during the Napoleonic Wars, and by the 1820s a major benefit to British farmers. They also, however, raised the cost of food ("the dear loaf," in the working-class propaganda of the day) and thus of wages. Perhaps just as important, supporters of Repeal believed that freeing British trade would help open markets

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<sup>3</sup> Even after the measure had passed the House of Commons, the landlord-dominated House of Lords threatened to reject it; their opposition was overcome only when the King, pressured by the Prime Minister and accommodationist Conservatives, threatened to create enough new peers to assure a majority for the bill in the Lords. The threat did not need to be exercised – once it had been credibly made, the existing Lords gave way – but this constitutional crisis suggested how high the stakes were and how much the balance of power had already shifted.

abroad. This would happen both because foreigners' enhanced ability to sell to Great Britain would increase their incomes, and their demand for British goods; and because they would be moved to reciprocate for British liberalization.

The impact of the protective tariff on the United States was prominently mentioned in the British debates. On the one hand, as manufacturer and free trade activist Richard Cobden noted, the tariffs reduced foreigners' income and encouraged them to produce their own manufactured goods rather than buy from Britain: "We offer [the Americans] no inducement to spread themselves out from the cities – to abandon their premature manufactures – in order to delve, dig, and plough for us." On the other hand, British protectionism reinforced the political position of the American protectionists. Home Secretary James Graham said in 1846, "We convert our natural and best customers, not only into commercial rivals, but into commercial enemies....They accordingly meet us with hostile tariffs; they impose high duties upon our manufactures."<sup>4</sup>

After over a decade of bitter battles in Parliament, in the press, and in the streets, in 1846 Parliament finally repealed the Corn Laws. Again, the struggle was intense and enduring: the Conservative Party split into Peelite (pro-repeal) and anti-Peelite (anti-repeal) factions, and the breach was not fully healed until the Prime Ministry of Benjamin Disraeli (earlier the leader of the anti-Peelite faction, but by then resigned to

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<sup>4</sup> James and Lake 1989, 18, 20.

free trade). The repeal of the Corn Laws marked the effective end of the age of mercantilism, and the beginning of an era of trade liberalization that became nearly synonymous with the rise of modern industrial capitalism in the nineteenth century.

In post-revolutionary France (once the Bourbons were finally displaced in 1830), strong elite support for capitalism came to the fore, at both the national and the local level. Pro-capitalist elites dominated both in the Orleanist monarchy (1830-1848) and in the Second Empire (1852-1870). Here, too, the crucial infrastructure for capitalist development was expanded: harbors, canals, railways, sometimes drastic urban renewal (Hausmann's rebuilding of Paris under Louis Napoleon). And in the Second Empire, beginning with the famous Cobden-Chevalier Treaty, France followed Britain in embracing free, or at least much freer, trade. In a particularly farsighted move, the Second Empire significantly advanced one of France's important exports, wine, by imposing a standardized system of ranks and labeling that assured buyers of the origin and quality of the product.<sup>5</sup>

Elsewhere on the European Continent, nascent capitalists similarly pushed to modernize existing institutions, yet here the prevalence of pre-capitalist modes of production meant that electoral reform or a wider franchise were rarely seen as the

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<sup>5</sup> The phylloxera epidemic, which killed off so many of France's vines, turned out to be only a temporary setback. To oenophiles, America more than repaid its debt to Lafayette by providing root stocks hardy enough to be immune to phylloxera.

answer. While advocates of wider markets, deeper finance, and larger enterprises sought similar policies – an end to local protectionism, the abolition of the remaining guilds, rationalization of agriculture (to free up rural workers for urban industry), and low tariffs on food -- Continental industrialists often allied with “modernizing autocracies” to achieve those goals.

As early as the eighteenth century, some of the Continent’s “enlightened despotisms,” most notably the Prussia of Frederick the Great and the Austria of Joseph II, had prepared the legal and institutional soil for capitalism, unifying and rationalizing legal codes, guaranteeing judicial independence, weakening or abolishing guilds, and dismantling barriers to internal trade. Politically, the earliest leap toward acceptance came with the founding of the independent kingdom of Belgium in 1830, which welcomed capitalist enterprise more than any other jurisdiction on the Continent. In post-Napoleonic Germany, and more particularly in Prussia, capitalist development was spurred by the Stein-Hardenberg reforms (1807-1811), which included abolition of most guild privileges, and by the expansion of the *Zollverein*, the customs union that embraced not only Prussia but an increasing number of its neighboring states: Mecklenburg, Saxony, Thuringia, Bavaria, Hesse.

Intellectuals, particularly in England, sometimes reinforced the broad evolution of public policies more favorable to modern urban, industrial capitalism. The most direct connection was between new generations of classical British political economists

and the new manufacturing interests. Thomas Malthus, James Mill, David Ricardo and Adam Smith all regarded mercantilism's restrictions as barriers to economic progress, its monopolistic practices as impediments to the advance of modern industry. They preached the value of competition, specialization, and comparative advantage to a receptive audience of dynamic entrepreneurs. Among historians, Thomas Babington Macaulay, the father of "Whig History," emerged as an enthusiastic supporter of the new, capitalist, expansive order. Across the channel, Physiocrats such as Quesnay and Turgot preceded the British political economists in their distaste for mercantilism and enthusiasm about competition and efficiency, although they saw farming, not industry, as the principal source of productive advance. These new philosophical and analytical trends reinforced the broad acceptance of the precepts of modern liberalism, and its general sympathy for modern industrial society.

*Opponents.* The enthusiasts, for all their energy, faced substantial opposition. Mass sentiment in France seems to have been very skeptical of capitalism. To the peasantry, secure ownership of their small farms was the signal achievement of the Revolution. Peasants were eager neither to mechanize, nor to see their young people drawn away by industry, nor (above all) to accept large imports of grain. The Revolution had also enfranchised French peasants, so that liberalization occurred only under authoritarian regimes (see above). It was peasant support that suppressed the Paris Commune, that later sustained the Third Republic and that steadily embraced the

restrictions on retailing and industry that kept France a nation at best ambivalent about modern capitalism.<sup>6</sup>

Most visibly, in the areas where traditional guilds and artisanal manufactures had dominated, resistance was far stronger than in France or Britain. Handloom weavers and spinners rebelled and smashed machines in many areas of Germany (Augsburg, Silesia, Saxony), emulating but far surpassing the English Luddites. Other crafts joined in, at first demanding enhanced protection by way of the prohibition of imports from outside the locality, or of the revision or abolition of the *Zollverein*. Eventually they perceived that any effective remedy had to come at a much broader level, and sought in the revolutions of 1848 a unified and democratic Germany. The noble aspirations of the revolutionaries' draft constitution of 1848 should not blind us to the fact that its major backers were the traditional craftspeople and that two of its crucial provisions gave the envisioned national government full authority to enact tariffs and to regulate trade and licensure. Had Germany achieved a democratic national government at this stage, the restrictions on capitalist enterprise would likely

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<sup>6</sup> Note, in Balzac's novels, how few of his striving Parisian characters hope to get rich from industry, or even from commerce; how many, from government favors, official appointments, aristocratic patronage, or (curiously, but related to all of the above) artistic success.

have been even more severe than those imposed by the democratic Third French Republic.

Many, if not most, European intellectuals and artists were opposed to, indeed often appalled by, the rapid rise of capitalism around them. Whether in industrializing England, post-Revolutionary France, or pre-revolutionary Germany, poets, playwrights, painters, novelists, can be counted as overwhelmingly anti-capitalist. In most of its aspects, Romanticism represented – despite its freshness of technique and its fondness for natural language – a visceral yearning for a lost, pre-industrial past. William Blake, most famously and most directly, saw “England’s pastures green” being displaced by “dark satanic mills.” But not by accident did Beethoven’s Sixth Symphony, a paean to a countryside untouched by industry or urbanization, rapidly become one of his most popular works. Wordsworth’s initial enthusiasm for the French Revolution<sup>7</sup> yielded quickly to the rustic longings of *Tintern Abbey*, and, with his close friend Coleridge, he drew inspiration not from England’s cities, harbors, or commerce, but from the pristine Lake Country. And even the Impressionists, although capable of lyrical urban scenes, often focused on the traditional countryside of haystacks and wheat fields, often

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<sup>7</sup> To be sure, the French Revolution and the experience of Napoleonic conquest hastened the artistic longing for a more orderly and idyllic past; but, with rare exceptions, intellectuals sought a pre-industrial, rather than an explicitly pre-revolutionary, past.

enough, once one notices, with a threatening, smoke-belching railway looming in the background.

Even more directly, many poets and commentators (foremost among them Heinrich Heine<sup>8</sup>) sided passionately with the displaced Silesian weavers in 1844-45. Decades later, the Naturalist Gerhard Hauptmann produced a tear-jerking account of their suffering, and of the horrid selfishness and hypocrisy of their capitalist employers, in his 1894 play, *Die Weber* (*The Weavers*).

*Unionism.* Industrialization, in addition to threatening many traditional economic actors and political and social traditionalists, created an industrial working class. This new working class began to organize itself almost as soon as it arose, and eventually became a significant political force in every industrial society (see Huberman, Volume 2: chapter 13). Its demands ranged from the purely economic to the broadly political, and from the mildly reformist to the openly revolutionary.

British workingmen began creating expressly political organizations in the 1790s, largely to demand greater rights, but these were largely suppressed in the general atmosphere of fear that followed the French Revolution. By the 1830s, when agitation picked up again, the character of the working class had changed. Those involved in the

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<sup>8</sup> Heine's poem "Die armen Weber," popularly retitled "The Silesian Weavers," first appeared in Karl Marx's newspaper *Vorwärts* in 1844 and was promptly banned in Prussia for its "subversive tendencies."

movements of the 1790s were largely craftsmen, artisans, and middle-class professionals, while the mobilizations of the 1830s and 1840s included large numbers of factory workers, a new category born of the previous decades of rapid industrialization.

British working-class hostility to capitalism – or at least to the form it had taken – was most clearly expressed in the Chartist movement. Chartism, organized around the People's Charter of 1838, agitated for universal male suffrage, the secret ballot, and a range of other reforms that would have given the working classes much greater access to the political system. They gathered millions of signatures on two great petitions to Parliament, organized mass meetings around the country, and led strike waves, especially in the industrial North and Scotland. The Chartists were met with hostility and repression by the British government, especially while the Revolutions of 1848 swept the European continent. Nonetheless, they directed national attention to the cause of more radical political reform, and to the new-found strength of the working class; and the Chartists arguably smoothed the way for the eventual adoption, over the next thirty years, of most of their proposals.

*Early socialism.* Other European revolutionary and reformist critics of capitalism were increasingly active in the 1830s and 1840s. This activism culminated, in most countries, in the multifarious Revolutions of 1848. In France and the German states, especially, the urban middle and working classes were prominent in demanding a greater role in political life. The revolutionary wave was very disparate, and did not

affect some countries, but nonetheless it indicated that there were substantial sectors of modern European societies that were profoundly dissatisfied with the conservative rule that had prevailed. Almost all of the revolutionary onslaughts were resisted, often brutally repressed, and the aftermath of 1848 largely saw a return to autocracy. Nonetheless, a generation of Europeans had seen mass movements in opposition to the reigning political and economic order.

The proliferation of working- and middle-class agitation for political and social change between the 1790s and the 1840s was accompanied by attempts on the part of European reformers to address the glaring and growing inequality they observed as industrialization proceeded. British and French social reformers, in particular, developed both trenchant critiques of the poverty and inequality they observed in the new industrial societies, and suggested more cooperative and egalitarian alternatives.

Most of these reformers – ridiculed by Marx and Engels as “utopian socialists” -- pinned their hopes on the establishment of new cooperative communities that would illustrate the possibilities of a more just, but still economically productive, social order. Such French thinkers as Charles Fourier and Henri de Saint-Simon, and such British thinkers as Robert Owen, encouraged the creation of these “utopian” communities. Owen himself took over his father-in-law’s factory town of New Lanark, Scotland, and turned it into a showcase of this more humane industrialism. Fourier’s followers set up dozens of such communities (among them Brook Farm, Massachusetts, and Corning,

Iowa, in the United States). Although New Lanark remained a model town for decades, most of the other utopian settlements lasted only a few years. Nonetheless, they provided reformist thinkers and activists with something of a model of what a different society might look like. So pragmatic a progressive thinker as John Stuart Mill evinced sympathy for Fourierist and other utopian socialists. Yet despite their broader appeal and impact, the movements were too small and isolated to have a profound effect on mass politics.

At the other extreme were anarchist and anarcho-syndicalist thinkers who argued for very radical change. Many of them, such as the Russian Mikhail Bakunin and the Frenchman Pierre-Joseph Proudhon, largely rejected private property and the modern state in favor of self-organized producers' communities grouped in loose federations. The early anarchists, in the 1840s and 1850s, mounted a powerful critique of the autocratic capitalism then prevailing, in favor of their "libertarian socialism." And anarchism appealed to intellectuals and workers in some countries.

In the 1840s, as these socialist currents swirled throughout Europe, Karl Marx and Friedrich Engels began their collaboration. They were leading members of the Communist League, an organization formed just before the 1848 revolutions and made up largely of German workers living in England. Although the Communist League was dissolved in 1852, Marx and Engels continued to work with radical opponents of capitalism around Europe. They became influential among the growing and disparate

groups calling themselves socialistic of one variant or another. Yet by 1860 there was no one dominant strand of socialist thought or action. There was, instead, a proliferation of working-class and middle-class reformers who shared a critical view of capitalism as it existed, and a desire to find a different way to organize society.

### **The heyday of modern industrial capitalism and laissez faire 1850-1914**

The opponents of European capitalism in the 1850s were of the most varied sort, ranging from feudal romantics to fiery communists; but European capitalism itself was gradually converging on a path toward the early British model. In the years after the repeal of the Corn Laws, most of Western Europe moved toward the kind of international economic integration that was the foundation of British economic policy. Two pillars of this model were free trade and the gold standard. With the Corn Laws gone and mercantilism a dead letter, Britain was committed to minimizing barriers to international trade.<sup>9</sup> With the Cobden-Chevalier Treaty of 1860, as already mentioned, France opted for trade liberalization, and over time most Western European countries followed. The Prussians, paradoxically, supported free trade with especial enthusiasm,

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<sup>9</sup> John Nye (2007) argues that the extent of British trade liberalization has been exaggerated; while his arguments are interesting, they remain outside the general historical consensus.

since the dominant East Prussian landlords were highly successful exporters of grain<sup>10</sup> -- a situation that would soon change. Outside Europe, many New World governments also liberalized trade, and integration into world markets was the order of the day. Over the course of the 1800s, the trade of the advanced countries grew twice to three times as fast as their economies; by the end of the century, trade was seven or eight times as large a share of the world's economy as it had been at the beginning of the century.<sup>11</sup>

The international gold standard emerged and solidified along with, and as a facilitator of, trade liberalization. Britain had been on gold since 1717, and as the country cemented its status as the global market leader, it attracted other countries to use the same monetary system. Over the course of the 1870s most major industrial countries joined the gold standard, committing themselves to exchange their currencies for gold at a pre-established rate. By 1879 most of the industrial world had adopted the gold standard.

The classical world economy of the 1850-1914 period, organized around free trade and the gold standard, saw a very high level of international economic integration.

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<sup>10</sup> The East Prussian landlords, as Barrington Moore observed, were at this time the rough equivalent of plantation owners in the U.S. South. Both depended heavily on export markets, and both vehemently rejected protective tariffs.

<sup>11</sup> Maddison 1995, 38. For an excellent survey of the period see Marsh 1999.

In addition to trade, international financial flows grew rapidly -- foreign investments, largely in bonds and stocks, accounted for about one-third of the savings of the United Kingdom, one-quarter of France's, one-tenth of Germany's (see James on global capital markets, Volume 2: Chapter 12).<sup>12</sup> International migration also grew rapidly, as fifty million Europeans and fifty million Asians left their homelands for new countries overseas. The international economy -- and most of the world's nations -- grew faster than they ever had. Indeed, the world economy grew more in the 75 years from 1840 to 1914 than it had in the previous 750.<sup>13</sup> This performance may well have merited its common label as a Golden Age of capitalism, or as (from 1815 to 1914) the Hundred Years' Peace,<sup>14</sup> but the spread of capitalism and its development in this period had many critics. There was plenty to complain about -- an agrarian crisis in Europe, colonial

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<sup>12</sup> O'Rourke and Williamson 1999, 209.

<sup>13</sup> The rapidity of growth is even more impressive on a per-person basis. According to Maddison 2001, page 264, world per capita GDP grew by barely 50 percent from \$435 in 1000 to \$667 in 1820, and then more than doubled to \$1510 by 1913. All data are in 1990 international dollars.

<sup>14</sup> The sobriquet conveniently overlooks the expansionary wars of Prussia, the bloodshed of the Paris Commune, and the outright slaughter of the U.S. Civil War (in which probably one in every twelve adult males perished); but these events, admittedly, paled in comparison to the butchery of World War I.

expansion in Asia and Africa, a Great Depression of prices that lasted nearly 25 years,<sup>15</sup> miserable conditions in the world's industrial centers, limited or non-existing democracy – and there were plenty of forms this protest took.

*Enthusiasts.* The principal supporters of the new order – both internationally and domestically – were again, not surprisingly, its principal beneficiaries. International financial, commercial, and industrial interests were able to take advantage of opportunities around the world, in an environment that largely welcomed global flows of goods, capital, and people. Within most countries, a consensus formed around the orthodoxy of the age. This orthodoxy privileged a country's international economic relations, even at the expense of some national concerns. The consensus included a commitment to the gold standard, to respect for cross-border property rights, to strong involvement in international commerce, and in most cases to free migration of persons. In the developed nations of Europe and North America, this consensus was embraced by most economic and political leaders, as well as by large portions of the middle classes. and even among workers, especially ones whose livelihoods were closely tied to international trade and investment.<sup>16</sup> Many European labor movements were, indeed,

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<sup>15</sup> This “Great Depression” is more accurately described as a “Great Deflation,” as nominal prices declined, especially for primary commodities.

<sup>16</sup> The U.S. “realigning” election of 1896 turned largely on fidelity to the gold standard (Populists and most Democrats having rallied behind William Jennings Bryan's

supportive of trade liberalization – in part because it meant cheaper food, in part because it meant greater access to foreign markets for their manufactures, and above all because it steadily raised their real wage.<sup>17</sup>

In the poorer nations of the world -- Latin America, parts of Asia, around the Mediterranean -- the orthodox consensus was largely restricted to a narrow elite. It also was quite loose with regard to trade liberalization – plenty of business leaders, especially in North and South America, had no problem with protecting industry, even while generally favoring both the gold standard and close commercial and financial ties with Europe. In any event, this internationalist elite typically exercised tight control over their countries' political and economic orders. If there was dissent from below – especially inasmuch as the sacrifices made to sustain a country's foreign commitments were imposed on those with little say in the matter – it was ignored or suppressed.

Nonetheless, the late nineteenth and early twentieth century witnessed a remarkable convergence among the economic and political leaders of most of the  

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advocacy of silver), and most urban workers rejected Bryan and adhered to gold-standard orthodoxy.

<sup>17</sup> Europe, relative to any other part of the world at that time, was abundant in labor: Central Europe had almost 120 inhabitants per square kilometer, Southern Europe 70, Northwestern Europe 55; East Asia, the next most densely populated region, had 45 inhabitants per square kilometer. United Nations 1961, 41.

world's countries. Almost all accepted that an open international economy was highly desirable; and that it was sensible and advisable for their nations to adjust their economic policies in order to maintain their ties to the international economy. At times this might mean imposing difficult austerity measures on a recalcitrant populace. *In extremis*, even the most internationalist of ruling groups might find themselves forced to go off gold – as Southern European and Latin American governments did with some regularity. But the goal remained full participation in the British-led global trading, financial, and monetary order; and this goal was more often achieved than not. As an indication, by the early 1900s, virtually every nation of any economic importance – save only China and Persia – was on the gold standard.

*The Statist alternative.* If most of the world admired and emulated the British model of unfettered capitalism, we must note that quite a different way emerged in this period, one that turned out both to be extremely important and, in some cases, to have a dark underside. This was state-led, or state-stimulated, industrialization: in its extreme form, state capitalism. Conservative leaders who saw the great advantages (not least in military power) that industrialization could bring, yet feared the social disruption it seemed inevitably to unleash, often decided to “guide” the process; and strong pre-existing states permitted them to do so.

These “conservative modernizers” sharply accelerated the pace of industrial development by accumulating and channeling capital, often through favored banks,

using state power to build infrastructure, and working in tandem with leaders of major industrial corporations. At the same time, to contain and defuse opposition in traditional sectors, these leaders pursued a three-pronged strategy: (a) toleration or encouragement of a re-ordered system of guilds; (b) state provision of extensive social insurance benefits; and (c) severe limits on popular participation in politics. In short, the conservative modernizers constructed a powerful state that accelerated capitalist development, sheltered the most threatened traditional sectors, and provided extensive social benefits, but opposed democracy.

The almost ideal-typical example is Wilhelmine Germany (and, before 1867, Prussia) under Otto von Bismarck. Even before Bismarck came to power in 1862, rapid capitalist industrialization had begun in Prussia's Ruhr district: coal, iron and steel, and above all railways developed rapidly from about 1850, the period now often called the *Gründerzeit* (Founding Era). Characteristically, the Prussian state invested heavily in many of the crucial early railways, but they remained under private management. The Ruhr's rapid development intensified the conflicts that had peaked in the 1848 Revolution, and the political threat to the existing order again seemed dire. While the Prussian monarchy had severely limited popular participation by the trick of retaining universal manhood suffrage (granted in 1848) while imposing a "three-class" electoral

system that empowered the wealthy,<sup>18</sup> even under that system the parliamentary representation of the mostly liberal Left steadily increased, until a majority of the Prussian state parliament refused supply: if the monarchy would not concede important powers, especially over the military, no money would be appropriated.

In this crisis, the King summoned Bismarck as Prime Minister. Bismarck simply ignored the constitution, appropriated the money (especially for the military), assured

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<sup>18</sup> In each parliamentary district, all adult males were listed in the order of how much direct tax they had paid in the previous year (most to least), and the total amount of direct tax collected in the district was also calculated. Officials then proceeded down the list until one-third of the total direct taxes had been accounted for. These were “voters of the first class,” and they were rarely more than ten per cent of the electorate; indeed, in areas dominated by large landowners, sometimes a single person.

Proceeding on down the list until the next third of direct taxes had been accounted for, one attained a list of “voters of the second class.” The taxpayers who provided the final third of total taxes (almost always the great majority of voters) were “voters of the third class.” At the polls, each group voted separately, and not for parliamentary candidates directly, but (among each group) for three members of an “electoral college.” After the popular votes were counted, the winning nine “electors” assembled and chose the actual MP. Thus, in practice, the wealthiest minority of voters normally held two-thirds of the votes that really mattered in electing the district’s representative.

himself of the support of the bankers and industrialists, and won a successful and popular war against tiny Denmark over Schleswig-Holstein. Buoyed by this victory, Bismarck called new elections, won a parliamentary majority, and forced passage of an Indemnity Bill that retroactively approved all he had done. From that point he never looked back.

The foundation of all Bismarck achieved, including Germany's rapid rise to the very front rank of European powers, was his scheme of state-capitalist industrialization at home. Together with his close friend, the brilliant Jewish banker Gerson Bleichröder<sup>19</sup> – who may fairly be called the “German Hamilton” – Bismarck reorganized German

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<sup>19</sup> It cannot have hurt Bismarck's chances that he was largely free of the fashionable anti-Semitism of the era – at least in his actions, if not always in his speech. He made sure that observant Jews were received regularly at court, exchanged home visits and dinner invitations with Jewish friends, sponsored the ennoblement of leading observant Jews (including first of all Bleichröder in 1872) , and – perhaps his most daring move – collaborated with Bleichröder and others to develop what is now the Grunewald area of Berlin (then a swamp) as the one *Villenviertel* (villa quarter) of the city that did not discriminate against Jewish buyers and indeed, by 1933, was about 40 per cent Jewish. The Grunewald development turned out to be personally lucrative to Bismarck, who (perhaps typically for the time) was not greatly constrained by conflict-of-interest considerations and had put a substantial part of his own money into it.

banking into a few large and interlocked conglomerates that could readily finance rapid industrial expansion.<sup>20</sup> Bismarck also involved the Prussian state directly in the leading industrial enterprises (Krupp, Thyssen), worked closely himself with many of the major industrialists, and made sure that government smoothed the path to their further expansion. Perceiving, for example, that the monopolistic freight rates of some of Germany's private railways were impeding industrial development, Bismarck (helped by Bleichröder) nationalized all of Prussia's railroads by 1880 and all of Germany's by 1889. And, of course, the large manufacturers of steel and armaments found much to like in the ever-escalating expansion of German armaments, including – a point at which even Bismarck drew the line – a big navy.

To guard against any repeat of the guild-led insurrections of 1848, and indeed to bind artisans and shopkeepers firmly to the state, Bismarck reversed decades of Prussian policy and re-invigorated those guilds that a modern economy could accommodate. Bakers, pharmacists, grocers, booksellers, and many other specialties were granted local monopolies by the state and could legally combine to set minimum prices.

The state's guarantee of monopolistic profits extended also to big business: cartel agreements that divided up the market (e.g., for steel or sugar) and set a common price were legally enforceable in Germany. Protective tariffs, enacted in 1879, shielded both

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<sup>20</sup> Stern 1977.

East Prussian estates and West German heavy industry (“rye” and “iron”) from import competition. While the system amounted to a consumer tax on the German economy, both Bismarck and Bleichröder were well aware that private wealth generated yet greater private investment; and indeed the titans of German industry plowed their super-profits back into their own industries and into the broader German economy.

The German state also directly subsidized research and development, not least in establishing the world’s first entirely research-oriented university system, with a particular emphasis on physics and chemistry. University researchers often worked closely with industrialists, and among the results were Germany’s early and almost total dominance of the world markets for synthetic dyes, industrial chemicals, and pharmaceuticals.

Finally, to contain working-class unrest, and as he believed to increase productivity, Bismarck enacted the first state systems of sickness, old-age, and disability insurance in Europe, the beginnings of the modern welfare state. These measures had also an ulterior motive, openly recognized even earlier, when Prussia had become the first country in Europe to outlaw child labor in the 1830s: healthier workers made better soldiers, and German officialdom paid close attention to any rise in the rate at which conscripts were rejected for service on grounds of disability or infirmity.

Bismarck’s system of state-led capitalism spurred a rapid growth of the German economy. Total real output more than tripled in Germany between 1870 and 1913,

against a rough doubling in the same years in France and the United Kingdom. Just before World War I, Germany produced as much steel as the rest of Europe put together, more than 90 per cent of the world's output of synthetic dyes, and the world's most advanced and successful pharmaceuticals.

Not surprisingly, other countries tried to imitate Germany's success. Most were at best pale imitations – Cavour in Italy, the tepid efforts (already mentioned) of the Orleanist monarchy and the Second Empire in France – but one came close to succeeding and another overtook and surpassed the German example. In Czarist Russia, Count Sergei Witte, as Minister of Finance with far more absolute powers than Bismarck ever enjoyed, pursued the same path of rapid railway expansion, cartelized industry, protective tariffs, and forced-draft investment (much of it from, or subsidized by, the state). In Japan, the governments of the Meiji Restoration (also uninhibited by parliamentary institutions) imitated Germany even more explicitly, modeling the Constitution of 1889 directly on those of Prussia and Germany<sup>21</sup> and adopting much of the German Civil Code of 1892 as their own in 1896. Japan also imitated Germany in its state-led industrialization and its strong emphasis on heavy industry and armaments.

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<sup>21</sup> A special commission made a world tour to study various possible Western models, including the U.S., British, Spanish, French, and German systems of government. Not surprisingly, the commission found the Prusso-German model worthiest of emulation.

*Progressives and reformers.* On both sides of the Atlantic, some “enlightened” members of the middle class deplored both the inequality and squalor of unbridled capitalism and the threat of working-class revolution. While remaining committed to democracy, and sometimes even embracing direct democracy, they sought answers in regulation of big business and empowerment of the less fortunate. Trusts were to be broken up (the Sherman Act) or constrained (the Interstate Commerce Act, the Food and Drug Act); factories were to be made safer, hours of labor limited, and workers given the tools to shape their own destinies (co-operatives, credit unions, settlement houses, even small garden plots for cultivation and a weekend escape from tenement living). On the European Continent, these policies were associated with Left Liberalism: the reformer Schulze-Delitzsch (also a Left Liberal politician) founded producer and consumer co-operatives, while others advocated credit unions for small farmers (*Raiffeisenverbände*) or urban workers (*Sparkassen*) to encourage savings and provide what now would be called “microfinance.”

In Europe, Left Liberals (or Progressives; the two names were interchangeable) increasingly found common cause with Socialists, not least on the issues of free trade and more vigorous government regulation. In the U.S., the movement reached its peak in Theodore Roosevelt’s 1912 run for the presidency as an independent Progressive candidate who framed the regulatory solution of the “New Nationalism.”

*Middle-class reactionaries and proto-Fascists.* The solutions advocated by the Progressives hardly sufficed for the owners of small farms and businesses, increasingly doomed by capitalism and terrified of socialism. Neither did traditional conservatism nor socialism appeal to these groups. A substantial part of them turned, especially after 1890, to a virulent and often violent strain of populist politics that rejected market economics and “cosmopolitanism,” dreamed of a restoration of the pre-capitalist order, and readily embraced anti-Semitism. To many of these groups, the threat of a new, unfamiliar, and more competitive world, and especially of a world market, could be attributed to one especially “cosmopolitan” group, namely Jews.

To these groups, it somehow followed that making Europe “free of Jews” would resolve all threats from capitalism -- or, for that matter, from Socialism -- and guarantee return to an idyllic and pastoral or small-town past. As the pioneering student of comparative Fascism Ernst Nolte first argued, these early anti-Semites and populist reactionaries focused their hatred on Jews as the embodiment of free markets, large-scale finance, and international trade -- in short, of a despised modernism.<sup>22</sup>

The strongest such movement, and indeed Europe’s first mass anti-Semitic party, was the Viennese Christian-Social Party, which drew on the organizational skills of the Catholic clergy and was led by the ex-Liberal Karl Lueger, who eventually won the post of Mayor of Vienna. Lueger’s anti-Semitism was particularly virulent, as in his 1899

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<sup>22</sup> Nolte 1963.

insistence that “the Jews here practice a terror as bad as anything that can be imagined.”<sup>23</sup> The aspiring young artist Adolf Hitler, then living in Vienna, later confessed his “unreserved admiration” for Lueger and his tactics. In Germany, an organized Anti-Semitic Party (or League) emerged as early as 1879 and struck deep roots in smaller towns, among struggling peasants, and among Berlin artisans.<sup>24</sup> Although it split and re-assembled continually, the movement was united in its opposition to liberalism of all stripes, and especially to Left Liberalism, which it denounced as “Jewified” (*verjudet*).

Relations between the populist anti-Semites and more traditional conservatives were complicated. In France, the movement called *Action Française*, inspired directly by the Dreyfus Affair, wobbled between monarchism (albeit for the Orleanist claimant) and simple hatred of the Third Republic, dominated (as they saw it) by “metics” (Jews and foreigners) and characterized by an increasingly sharp distinction between Church and State.

Yet on the eve of World War I, the populist anti-Semites were on the wane, while Socialism was steadily rising.<sup>25</sup> Indeed, Lueger won power in Vienna only on the basis

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<sup>23</sup> Geehr 1990).

<sup>24</sup> For a close study of one such party, and of the background from which it sprang, see Norda 2009.

<sup>25</sup> Levy 1975.

of a restricted franchise; the Social Democrats won, and expanded, a majority of the popular vote.

*Socialist labor.* Karl Marx, who died in 1883, would have been surprised at how quickly and completely the European working-class movements adopted his brand of socialism in the late nineteenth and early twentieth century. Friedrich Engels lived until 1895, and he too would have been amazed at how rapidly Marxist socialism swept through European labor movements, and how quickly the labor movements came to influence European electoral politics.

The modern socialist movement can be dated to an 1864 meeting in London, which established the International Workingmen's Association (often called the First International). The organization eventually came to comprise a wide variety of radicals from around Europe, including trade unionists, republicans, nationalists and anarchists. While the relationship between the First International and the various national movements was sometimes weak, its activities reflected the gradual rise of a serious, organized movement in opposition to capitalism, one that found substantial support among working-class and middle-class reformers and revolutionaries.

The culminating moment of the First International's epoch was the Paris Commune, which ruled the French capital for a couple of months in spring 1871 in the aftermath of Prussia's humiliating defeat of France in the Franco-Prussian War. The Commune – and similar uprisings in some other French cities – represented a

thoroughgoing challenge to the rule of Europe's conservative political and economic elites. Its violent suppression stifled the socialist movement, and the experience contributed to a major split between the followers of Marx and the organization's large anarchist membership. In 1876, the First International disbanded. Despite repression and the end of the International, there was little question that the underlying sources of support for the socialists and related revolutionaries remained.

Over the course of the next few years, socialist parties gradually organized around Western Europe. The most important developments were in Germany, where a merger of existing organizations created the Social Democratic Workers' Party (SDAP) in 1869 and the Socialist Workers' Party (SAP) in 1875. Although Bismarck's anti-socialist laws made the party illegal a few years later,<sup>26</sup> it continued to grow over the next decade. Meanwhile, socialist parties of one sort or another were forming all over Europe – in Denmark in 1876, Belgium in 1885, Norway in 1887, and Austria in 1889. In July 1889, representatives from two dozen countries met in Paris to create a new Socialist (or Second) International. By then, many of the constituent parties were significant political forces in their homelands. Within a year, the newly legal and newly renamed Social Democratic Party of Germany (*Sozialdemokratische Partei Deutschlands* or

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<sup>26</sup> Despite the ban, Socialists continued a vigorous underground existence and even managed to publish newspapers and elect representatives (not so labeled, of course) to the *Reichstag*.

SPD) was receiving 19.7 percent of the vote in national elections, more than any other party and almost double what it had won in elections only three years earlier.<sup>27</sup>

The movement signaled its sympathy for Marxist ideas by electing Friedrich Engels as its honorary chairman in 1893. Engels returned the favor by accepting, shortly before his death in 1895, that times had changed so much that “We, the ‘revolutionaries,’ the ‘overthrowers’ — we are thriving far better on legal methods than on illegal methods and overthrow.”<sup>28</sup> The socialists’ electoral successes were having much more impact than the illegal and conspiratorial methods of the past. By this point, the socialist parties and movements were primarily concerned to reform the capitalist system, even if many of their leaders and followers believed in the desirability and inevitability of its eventual overthrow. A combination of labor organization and electoral mobilization turned out to be remarkably successful at making the socialists central players in the rapidly democratizing political systems of the late nineteenth and early twentieth centuries. However, socialists and other radicals remained relatively weak in most of

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<sup>27</sup> In 1890, the Catholic Center Party came in a close second, at 18.6 per cent; the National Liberals and Progressives (Left Liberals) each won about 16 per cent; and the rest of the vote went to conservative and regional parties. Already at this point, what would become the dominant “Weimar Coalition” of the First Republic, Socialists, Center, and Left Liberals, commanded a majority of the electorate (about 55 per cent).

<sup>28</sup> Engels 1895.

the Areas of Recent Settlement, for reasons that probably combined economic, political, and cultural factors.

On the eve of World War One, socialist parties and their related trade unions were among the most powerful political forces in most Western European countries. At their pre-war peak, socialist parties were getting between 15 and 25 percent of the vote in France, Italy, and Austria; and 30 to 35 percent of the vote in Belgium, Germany, and Scandinavia.<sup>29</sup> In 1916, Finland's socialists received a remarkable 47 percent of the vote, which gave them a parliamentary majority and allowed them to form the national government as it prepared for independence from Russia (Sassoon 1996, page 10) Some of the most theoretically consistent, internationally unified, and extreme opponents of the classical capitalist order seemed to have arrived at the gates of the fortress, whose defenders were in any event thinning rapidly and often enough on the verge of panic.

### **Globalizing capitalism in the rest of the world – 1870-1914**

Modern industrial capitalism spread rapidly from its northwestern European origins, finding especially fertile soil in the Areas of Recent Settlement (see Allen,

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<sup>29</sup> In the German national elections of 1912, the Socialists received 34.8 per cent of the vote, the Left Liberals 12.3 per cent, and the Center (Catholics) 16.4 per cent. The combined Conservative vote totaled a mere 11.5 per cent, and the National Liberals, as the most consistent defenders of untrammelled capitalism, won only a little over one voter in every eight (13.6 per cent).

Volume 2: Chapter 8). These were regions that either had sparse populations when Europeans arrived, or whose populations had been decimated by the arrival of Europeans (purposely or not): the United States, Canada, Australia, New Zealand, the southern cone of Latin America (Argentina, Chile, Uruguay, southern Brazil). There were other regions outside Europe that also took enthusiastically to the new international economic order. Most took advantage of booming European demand for primary products; many tapped the great European financial markets for capital. Some began a rapid route toward industrialization themselves, both by more or less natural means and with the help of protective government policies.

*Enthusiasts.* There is little mystery in the expansion of modern capitalist economic and political patterns to many of the Areas of Recent Settlement (ARS): they were former or current British colonies and simply replicated British socio-economic and political patterns, adapted to local conditions.

It is a bit more complicated to explain how and why other regions so easily accepted the pillars of the classical international economy, the gold standard and free trade. In some, such as the southern cone of Latin America, the socio-economic structure was roughly similar to that in the English-speaking ARS. They had ample supplies of fertile temperate land, ideally suited for growing wheat or raising cattle. Once advances in the technologies of transportation (and eventually refrigeration) made it feasible to ship wheat and beef from South America to Europe, production in these

regions grew dramatically. In the early 1880s, Argentina exported only 1.6 million bushels of wheat – barely one percent of U.S. exports; on the eve of World War One, less than 30 years later, Argentine wheat exports were 93.6 million bushels, over 85 percent of U.S. exports. The growth in Australian and Canadian wheat exports was comparable.<sup>30</sup> As the economies of these countries were completely reoriented, so too were their political economies largely remade to place the beneficiaries of links to European markets at the centers of power.

In these Areas of Recent Settlement – whether present or former English colonies , or booming South American temperate resource exporters – national economic and political elites were closely aligned with global economic interests, and closely allied with the centers of the classical world economy, London in particular. The economic policies they favored, and were typically able to have adopted, were aimed at securing access to European markets, European goods, and European capital on the best possible terms. This usually meant adhering to the gold standard, pursuing “reasonable” macroeconomic policies, and maintaining relatively open markets. It did not necessarily mean free trade: most of these countries had high tariffs on manufactures, for some combination of revenue and special-interest reasons.<sup>31</sup> Nonetheless, there was little question about elite commitment to participation in the global economy.

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<sup>30</sup> Harley 1980, 218-250.

<sup>31</sup> Coatsworth and Williamson 2004, 205-32.

Along similar lines, there were a number of European colonial possessions for which the golden-age expansion had strong positive effects –at on powerful local groups. Parts of South and Southeast Asia and West Africa tapped into world markets for tea, rice, and rubber, and for cocoa, groundnuts, and palm oil. Some of the farmers who prospered as a result were European settlers; but in many instances, local elites developed around the lucrative colonial trade.<sup>32</sup>

Another group of reasonably enthusiastic members of the classical club was made up of countries that began the period in a semi-industrial state and wanted to catch up to the European capitalist centers. This included countries on the European periphery – Spain, Russia, Austria-Hungary – as well as some farther afield, such as Japan. While all these countries' governments had some reservations about the way the world economy was ordered – and in particular their relative weakness in that order – they were all eager to join the ranks of the industrialized world.

Japan, as we have already noted, was an especially enthusiastic emulator of the Western model. Horrified by the nearby experience of growing Chinese subjugation to the West, the Meiji leaders regarded rapid economic growth as essential to continued Japanese independence. Importing Western technologies, they also funneled state funds into investment; forbidden by treaties to raise tariffs, they subsidized domestic monopolies that taxed domestic consumers to provide yet more capital for investment.

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<sup>32</sup> E.g., in West Africa. The classical account is Hopkins 1976.

Railroads, shipping facilities, steel mills, coal mines all sprang up rapidly. Japan's results also paralleled those of Germany: between 1870 and 1913, real Japanese total output almost tripled.<sup>33</sup>

*Rejectionists.* Not all of the developing world was enthusiastic about participation in the classical capitalist world economy. The world's most populous country, China, was particularly reluctant to subordinate its long-standing insularity to the needs of international economic engagement. China's imperial government regarded modern economic growth as a threat to its authority, both because it would create powerful business interests that might challenge the bureaucracy and its landed supporters, and because it would inevitably open the country and its people to foreign influence. The Chinese central government tried continually to limit the impact of foreign powers, and foreign businesses, on Chinese society. While this was often justified on nationalist military grounds, it is hard to see how retarding economic growth did anything but accelerate the country's descent into diplomatic degradation. And even when it came to purely domestic measures to encourage economic growth, the Chinese government lagged seriously – development of the country's railroad system was two or three decades behind that of Japan or India.

India, with rare exceptions, resisted capitalism for the simpler reason that it experienced it in the form of exploitative colonialism. The British East India Company,

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<sup>33</sup> Maddison Historical GDP Data.

chartered in 1600 by Elizabeth I and subsequently granted both a monopoly of trade and extensive powers of rule and taxation, had come by 1813 to control, either directly or through vassal princes, all of the subcontinent except the Punjab, Sindh, and Nepal. The Company's exploitation, via unequal terms of trade, heavy land taxes, and a legal regime that privileged the British and their allies, supposedly came to an end in 1858, when Parliament, outraged by the Sepoy Mutiny against the Company's misrule, passed the Government of India Act, nationalized the company, and imposed direct British rule on the whole subcontinent (again, excepting the princely states).<sup>34</sup>

Direct rule, including the institution of the highly professional Indian Civil Service, was less corrupt and brought significant improvements in infrastructure; yet, as E. J. Hobsbawm put it succinctly, India "was the one part of the British Empire to which *laissez-faire* never applied."<sup>35</sup> Instead, it remained a captive market for British manufactured goods, especially cotton textiles, where the Indian market accounted by the 1880s for over forty per cent of Britain's total exports of such goods.<sup>36</sup> India was also a major revenue source for the Crown via so-called "Home Charges," India's fee for being administered by Britain. Above all, it was a supplier of such raw materials as wheat, cotton, and jute to British industry. A variety of policies discouraged the

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<sup>34</sup> See Tomlinson 1993 for an overview.

<sup>35</sup> *Industry and Empire* 1968, 148.

<sup>36</sup> *Ibid*, 147.

development of domestic industry. Two results were clear: India's economic growth was much slower (total output increased by only about 60 per cent between 1870 and 1914,<sup>37</sup> versus the tripling that Japan experienced in the same period); and India, more than other less-developed regions, experienced recurrent large-scale famines, e.g., in 1876-78, 1896-97, and 1899-1900.

### **Capitalism between the wars, 1918-1939**

World War I was a turning point in the development of modern capitalism. To be sure, most of the trends that characterized the capitalist world after 1918 were present in 1914; but the war and its aftermath heightened virtually all aspects of the system, including some of the more troubling. Before 1914, the core parties and movements of both Right and Left were oppositional but not radical; there were mainstream movements on both sides that strove to remake capitalism in a different image. But there were few serious supporters of a radical break from the capitalist order, and these few had little influence.

After 1918, all that changed. As the interwar period wore on, it became increasingly evident that the classical capitalist order that had prevailed before World War I could not be restored. Radical movements of both Right and Left developed and grew stronger, in the face of the obvious failures of any semblance of a centrist capitalist consensus. The results were disastrous.

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<sup>37</sup> Maddison Historical GDP Data.

*Enthusiasts and their failures.* In the aftermath of the wartime breakdown of the world economy, the political and economic leaders of most of the world's principal nations shared an interest in restoring the pre-war international economic order. Classical capitalism had worked reasonably well, and there was little reason to abandon it. Elites in virtually every developed society continued to support open trade relations, easy cross-border capital movements, and the monetary stability of the gold standard. And so in the years after World War One, the major powers endeavored to restore the open international order of the pre-1914 era.

And yet every attempt to reconstitute the classical international economy failed. Despite continuing rounds of meetings, conferences, and consultations, the signing of agreements, and the establishment of new international institutions, it seemed impossible to restore the pre-war international economic order. The brief return to relative normalcy after 1924 collapsed as soon as recession hit in 1929, with devastating effect.

Many forces led to the failure of interwar capitalism, but there was no real shortage of enthusiasts who favored a restoration of some form of open capitalist system.<sup>38</sup> There were supporters of open trade relations and free capital movements everywhere – and they often dominated the making of economic policy. The same was true of the gold standard. When the United Kingdom returned to gold at the pre-war

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<sup>38</sup> Frieden 2006, chapters 6-10, covers this period in detail.

exchange rate in 1925, the overwhelming weight of established opinion around the world saw this as a normal and natural thing to do.<sup>39</sup> However, as Keynes argued at the time, and subsequent analysis has largely confirmed, the commitment to a restoration of pre-1914 conditions ignored the very substantial economic, social, and political changes that the industrial nations had undergone in the interim.<sup>40</sup>

Some of the enthusiasts remained firmly committed to gold-standard orthodoxy, even after the collapse of the 1930s, and indeed blamed the prolonged Depression on the failure to adhere to the gold standard. Others, who came to the fore during the Depression, were strong supporters of open markets at home and abroad but were willing to make compromises to sustain them. The center-right and center-left in Europe – largely Christian Democrats on the one side and Social Democrats on the other – shared the view that capitalism was better than the authoritarian alternatives at either extreme. So too did America's New Dealers and analogous political movements (in or out of government) in Canada, Australia, and New Zealand. And these less orthodox defenders of capitalism tried to navigate a middle ground that maintained or restored some semblance of economic openness, on the one hand, and that permitted a politically desirable degree of government involvement in the economy in times of

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<sup>39</sup> See, for example, Eichengreen and Temin 2000, 183-207.

<sup>40</sup> Eichengreen 1996 is the classic statement of this case.

crisis, on the other.<sup>41</sup> In much of Western Europe and the Anglo-American world, this sort of compromise was reasonably successful – and presaged the post-World War Two settlement – but it failed miserably elsewhere.

*Rejectionists and their successes.* As capitalist orthodoxy failed, and as halting attempts to find another liberal way forward stalled, extreme alternatives came to the fore. From the vantage point of the late 1930s, traditional capitalist forms of economic organization seemed outmoded, and certainly outnumbered. The wave of the future appeared to be semi-autarkic, authoritarian, command-style economies, of the fascist or communist variety.

*Fascism.* World War I fundamentally re-ordered world capitalism and put its various regions on divergent paths. The U.S., Japan, and Latin America, spared from the brunt of the conflict and able to purvey crucial supplies and credit to the belligerent powers, prospered. The United States in fact went from being the world's greatest debtor to its largest creditor. However, the war-ravaged states of Europe were bankrupt, saddled with debts and, in the case of Germany, reparations, they could not repay except by destroying their own economies. But these were not their only burdens. Wartime demand had built overcapacity in such armaments-related industries as steel, and had created whole new sectors (synthetic nitrates, for gunpowder and fertilizer) that now lobbied for protection that would preserve their wartime domestic monopolies.

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<sup>41</sup> Ruggie 1982 is a well-known statement of the point.

Wartime hatreds, sometimes coupled with long-simmering nationalist resentments , amplified the demand for tariff barriers and self-sufficiency. Vast numbers of demobilized troops, many of whom had served at the front for as long as four years, returned home to face unemployment, families they barely knew, societies that had changed fundamentally (or that they had outgrown).<sup>42</sup> A younger generation of males, just short of military age, grew up fatherless – their fathers were either dead or had been perpetually at the front – and obsessed with the propaganda of wartime heroism. At the same time, women moved into non-traditional occupations, particularly in industry, to replace the male conscripts.

Moreover, wartime shortages of labor, regime acquiescence in the growth of trade unions, and the example of the Bolshevik Revolution had radicalized the working class, while postwar repudiation of public debts, whether explicit or via inflation, impoverished much of the respectable middle class.

All of this proved an exceedingly toxic brew. First in Italy and Portugal, then in Germany and Austria, still later in Spain and much of Central Europe, the dispossessed middle class and peasantry rallied around movements led by war veterans, staffed in

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<sup>42</sup> It was not only in the U.S. that people asked, in the words of the popular song of the time, “How are you gonna keep them down on the farm, after they’ve seen Paris?”

their middle ranks by the men who had been too young to serve, and obsessed with hyper-nationalism, anti-modernism,<sup>43</sup> and (in most cases) anti-Semitism.

The new fascist movements purveyed the machismo and the authoritarian leadership of the wartime front. They were fanatically anti-Socialist and anti-Communist, seeking national glory and conquest, and (often as a corollary) advocating a rigidly autarkic economic policy, Fascism offered simplistic and seemingly efficient answers to the anxieties of the postwar peasantry and middle class. Replace disorderly democracy with tough and hierarchical leadership, re-establish traditional patriarchy, break trade-union power, exclude threatening imports, preserve traditional agriculture, restore national pride, and if necessary conquer sources of needed raw materials. These appeals enjoyed a burst of popularity in the immediate postwar chaos (and, indeed, carried Fascism to power in Italy in 1922), waned as prosperity and trade partially revived in the mid-1920s, and then again won both popular and elite support as the world economy fell into Depression and autarky after 1929.

While Fascist movements were many –they arose even in Britain and the U.S.– they achieved the “totalitarian” power they aspired to in only a few countries, most notably Italy, Germany, Spain, and Japan. Only in Germany did Fascism originally

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<sup>43</sup> In most cases, this extended to a renunciation of modern (or, as the Nazis called it, “degenerate”) art and music. Italy, where the artistic movement of Futurism found a mutual embrace with Fascism, was the rare exception.

achieve substantial electoral support, but once in power and able to display significant achievements in foreign and economic policy, Fascism often won enthusiastic popular support, particularly of course among its beneficiaries: the peasantry, the traditional middle classes, the military.

Germany is of particular interest because we know, or can reliably infer, much more about who supported Fascism – or, more precisely, who did not, at least so long as elections remained free and fair. At both the national and the district level, Catholic and working-class voters remained almost wholly immune to Fascist appeals. As economic conditions worsened, many Socialist voters shifted to Communism, but in very few cases to Fascism. German Catholics, under clerical pressure, remained doggedly loyal to their traditional Center Party. Rather, the Nazi vote rose almost in direct proportion to declines in the traditional middle-class Liberal parties, above all the right-liberal German People's Party (DVP) of Stresemann and the left-liberal German Democratic Party (DDP) of Rathenau.<sup>44</sup> Fascism appears also, rather late in the game, to have siphoned off about half of traditional monarchist support (the German National People's Party, or DNVP, which the press lord Hugenberg enthusiastically supported), and to have won some new support from previous non-voters. Those constituencies,

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<sup>44</sup> The DVP traditionally drew its support from big industry and elite professionals; the DDP, from small business and mainstream professionals. As one adage of the time went, academics voted DDP until they received tenure, then shifted to the DVP.

however, paled in comparison to the hordes of previous Liberal voters who went over to the Nazis. It was this “treason of the Liberals” that led Seymour Martin Lipset, somewhat misleadingly, to classify Fascism as an “extremism of the Center.”<sup>45</sup> So far as we can tell, Fascism in most other countries drew its strongest support from the traditional Right – albeit, admittedly, mostly from the middle-class supporters of the traditional Right.

Did Fascism support, or oppose, capitalism? While it certainly opposed (and expropriated) “Jewish capitalism,” Fascism readily collaborated with each country’s major industrial firms and trusts, especially those crucial to its plans for territorial expansion and aggression: steel, armaments, aircraft, energy, chemicals, and construction. At the same time, the Fascist regimes did not hesitate to seize firms that resisted their plans or carried them out too slowly; they frequently founded state-owned firms in sectors they deemed especially important ; and, above all, they renounced capitalist orthodoxy about free international trade, ruthlessly pursuing autarky, even when doing so condemned millions to hunger, starvation, or the more “humane” route of extermination.<sup>46</sup> Moreover, in pursuit of their anti-modernist vision of society, the Fascists excluded from the industrial workforce, to the extent possible,

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<sup>45</sup> Lipset 1960, chap. 5.

<sup>46</sup> Tooze 2006 has now become the authoritative study of German economic policy under the Nazis.

important segments of the population – especially women and peasants – even when doing so compromised their wartime efficiency.

The Fascist efforts at world domination seem, in retrospect, audacious to the point of foolhardiness: taken together, the Fascist powers had even at the height of their conquests nothing like the industrial capacity of the United States and the British Empire or the manpower of the Soviet Union. That said, it must be admitted that they came perilously close to winning, and that such a victory would have altered capitalism to the point of destroying it.

The interwar experience is a striking illustration of how the failures of capitalism, and particularly the wars that disrupt it, can inspire rabid and highly destructive resistance to it (see Harrison on war, Volume 2: Chapter 4). Nonetheless, the complete defeat of Fascism by 1945 set the stage for a triumphal revival of world capitalism, this time under American leadership, and indeed for a “Golden Age” of economic growth, social peace, and expansion of the welfare state in most capitalist countries. The darker side of the victory was that capitalism now faced a more effective and determined opponent, Stalinist Communism, that dominated almost half of the globe.

*Communism.* World War One, the Russian Revolution, and the electoral successes of European socialist parties cemented the division in the world socialist movement between Socialist (or Social Democratic) and Communist parties. By the 1920s, the former were firmly committed to participation in democratic political processes, and

had realized substantial successes. The latter, on the other hand, were dedicated to a twofold mission: defending the Soviet Union, and organizing revolutionary movements in the capitalist world.

The emergence of the Bolshevik wing of the Russian socialist movement as the ruling force in the world's largest country shocked both the capitalist world and the socialist movement. By the early 1920s it was clear to both that the Soviet Union was not a passing aberration. In the advanced industrial countries, the principal implication was that the more extreme elements of the socialist movement were now separate and organized into a disciplined, international force under Soviet direction. This was a new phenomenon: a global radical movement in control both of a large territory and of opposition parties around the world. The emergence of the Soviet Union itself was of somewhat less consequence, as it was economically and militarily weak and played little role in international politics. But the movement organized by the Soviet-led Communist International was a meaningful force in dozens of countries around the world, especially after the Depression magnified the miseries that many identified with capitalism.

Communism was a major political force in only a few industrialized nations, and achieved success in none of them. Foremost among these, however, was Germany, the troubled centerpiece of interwar European politics. In some southern European countries, too, Communists inherited some of the support of previously powerful

radical socialist and anarchist movements.<sup>47</sup> The strength of the Communists helped provoke extreme right-wing reactionary takeovers of government in such countries as Italy and Portugal, and led to a decade of conflict and civil war in Spain, ending in an even more brutal right-wing authoritarianism. And the polarization of German politics certainly contributed to that country's troubled path. Indeed, the rise of right-wing extremism eventually led Communists, in Moscow and elsewhere, to move away from insurrection and to search out moderate allies who would cooperate both to defend both democracy and the Soviet Union.

In the colonial world, Communism had substantially more success. The Soviet Union allied itself with anti-colonial activists in the developing world. Hostility between the Soviets and other Western powers gave credibility to the Communists' anti-colonial credentials. And the Soviet Union made much of its efforts to create a progressive multinational state out of the tsarist prison-house of nations. For many in the colonial world, the Soviet Union was represented by the new socialist republics in central Asia, among the first regions in the Islamic world to modernize everything from the alphabet to the economy. Soon many of the Soviet Union's supporters were prominent in movements against colonialism, and the Soviet Union itself appeared to

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<sup>47</sup> In Spain, however, the Communists often battled the anarchists, to the sole advantage of Franco: Orwell 1952 [1980].

be a viable alternative to colonial and semi-colonial patterns of economic and political development.

Communism's appeal remained somewhat limited through the 1930s. The Soviet Union was too weak and isolated, and the Communist movements too far from real influence, to have a substantial impact on the political life of the world's major countries.<sup>48</sup> Nonetheless, both the socialist homeland and the Communist movement came to represent a clear alternative to traditional capitalism and authoritarian fascism. The true division of the world between Soviet-style socialism and American-style capitalism did not come until after World War Two.

### **Contemporary capitalism**

The capitalist world economic order that emerged after World War Two was unprecedented on at least two dimensions. First, its broad outlines were negotiated by the major economic powers, largely at meetings held at a resort hotel in Bretton Woods, New Hampshire. The Bretton Woods system represented an organized and planned attempt to reconstitute a functioning, relatively open, international capitalist system. Second, world capitalism was confronted by a full-fledged alternative international economic order, the world socialist camp headed by the Soviet Union. This alternative

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<sup>48</sup> Nonetheless the Communist Party of Germany (KPD), by refusing all co-operation with the Social Democrats, whom the KPD routinely denounced as "Social Fascists," contributed significantly to bringing the Nazis to power.

to capitalism, now stretched from central Europe to Korea, included the world's most populous country, and attracted adherents from all over the colonial world.

*Enthusiasts: The Bretton Woods compromises.* As World War Two wound down, the major powers agreed upon the broad contours of the post-war international economy.<sup>49</sup> Although the system as implemented was different from the plans on paper, its general characteristics were roughly as envisioned by Allied policymakers, led by Harry Dexter White of the United States and John Maynard Keynes of Great Britain. The post-war order was a wide-ranging compromise between the classical open economy of the nineteenth and early twentieth centuries and the emerging welfare states of the advanced industrial countries. The arrangements put in place reflected the views of the reformist supporters of capitalism who had come to the political forefront in the 1930s, and who dominated the "centrist consensus" that reigned for decades after the war ended.

The core principles of the Bretton Woods system included general commitments to international economic integration, to multilateral agreements, to international organizations, and to gradualism. The three great Bretton Woods international economic institutions covered trade (the General Agreements on Trade and Tariffs, or GATT, since succeeded by the World Trade Organization or WTO), monetary and

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<sup>49</sup> This section relies upon the material in Frieden 2006, chapters 11 and 12, which see for more detailed discussion and references.

financial relations (the International Monetary Fund or IMF) and development (the International Bank for Reconstruction and Development or World Bank).<sup>50</sup>

In trade, the Bretton Woods dedication to trade liberalization was tempered by a recognition that some sectors would be too contentious to allow rapid progress. As a result, barriers to trade in farm goods were explicitly excluded from the liberalization agenda, as was trade in services; developing countries were given wide leeway to pursue protectionist measures. In addition, countries were permitted to impose temporary trade barriers in response to “dumping,” under circumscribed conditions, and more broadly in times of (ill-defined) economic necessity. This gave governments leeway to use “escape clauses” to avoid or postpone politically difficult measures, which in turn made it easier for them to participate in the liberalizations GATT members were bargaining toward. The reduction in trade barriers was slow but continual, and by the late 1960s trade among the developed countries was roughly as free as it had been in the late nineteenth century – and was growing twice as rapidly as it had then.

The IMF oversaw the construction of a highly modified gold standard, in which the U. S. dollar was pegged to gold and other currencies to the dollar. Again, the

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<sup>50</sup> The GATT was in fact the “interim” solution to the failure of the original treaty establishing the International Trade Organization to meet with the approval of American legislators.

compromises involved were substantial. The United States could not alter its exchange rate, but other countries could and did, as permitted in response to (undefined) “fundamental disequilibria.” Capital controls were ubiquitous, as Keynes and White had anticipated. The result was a monetary system that provided stability on the foreign exchanges, while allowing governments to pursue their own desired monetary policies and in particular to engage in demand management as they felt necessary. The World Bank, for its part, assisted in rekindling the interest of foreign investors in the developing and newly independent countries. In this atmosphere of monetary and financial stability, world financial markets and foreign investment grew rapidly.

The Bretton Woods system was a great success, as the world economy grew more rapidly than ever before. Yet this very success made the system hard to sustain, based as it was on compromise. The more integrated the international economy became, the harder it got to sustain truly independent national policies. Eventually the contradictions of the system caught up with it. In 1971 the monetary order collapsed, to be replaced by floating exchange rates. More generally, the major compromises of the early post-war period began to come undone as the world economy grew and became ever more tightly integrated. Nonetheless, the enthusiasts for capitalism were firmly in command of the levers of economic policy in developed countries. Things were not so clear in the developing countries, especially among those who had recently freed themselves from their colonial ties.

*Skeptics: Decolonization and developmentalism* . In the less developed countries (LDCs), enthusiasm about classical capitalism faded during the inter-war period. To some extent this was due to the sorry record of interwar capitalism itself. From the standpoint of the independent LDCs and of many colonies, the entire period from 1914 until the early 1950s was one in which events in the developed world were largely irrelevant or harmful. The industrialized nations were preoccupied with war and reconstruction for a decade after 1914. After a brief normalization came the Depression of the 1930s, during which international trade and investment collapsed; and then came another decade of preoccupation with war and reconstruction.

For nearly forty years, the developing world had little choice but to rely largely on its own economic resources. Export markets were depressed or cut off by war, while suppliers of manufactured products were often producing for war or reconstruction efforts. Even when foreign manufactures were available, the terms of trade deteriorated so frequently and substantially that they were priced out of local markets. All this created powerful incentives for local entrepreneurs to produce industrial products that had previously been imported, largely from Europe or North America. The result was rapid industrialization in both the independent developing countries, such as the major Latin American nations and Turkey, and in many of the more developed former colonies, such as India.

Decolonization gathered speed from the late 1940s onward, even as world trade and payments revived (see Austin, Volume 2: Chapter 3). However, the previous 40 years' experience had a powerful impact on the politics of development in both long-independent and newly-independent developing countries. There were now significant industrial sectors in many countries, and the enterprises that had grown up more or less immune from foreign competition had little desire to change matters. At the same time, political influence had largely passed from the previously dominant export-oriented groups – farmers, miners, ranchers – to the urbanizing, industrializing segments of local populations. All this was wrapped in a commitment to construct national, and nationalist, identities, often in contradistinction to the now reviled colonial and semi-colonial rulers and their open-economy models.

The result was that virtually every LDC turned away from world trade and toward the protection and subsidization of domestic industry. The new strategy, eventually dubbed “import-substituting industrialization” (ISI), provided support for domestic industry that included import barriers, subsidized credit, tax breaks, and other policies to replace imports with domestic products. Countries whose economies had been strongly oriented toward foreign trade now closed themselves off to many imports, and in some instances, to foreign investment as well. ISI often went together with substantial state involvement in the economy, with government ownership of everything from mines and steel mills to banks and airlines. In many cases, as in India,

this inward orientation was associated with Soviet-style planning; in others, it was simply a part of nationalist attempts to develop the local market.

Nationalist economic policies were typically justified with a bitter criticism of the structure of the capitalist international economic order. For some, a new “dependency theory” provided some intellectual justification, arguing that global capitalism was structurally biased against poor countries. Some insisted that the terms of trade of primary producers deteriorated continually, so that following comparative advantage was a dead end. Others complained about a world economy whose rules were written by the rich. Still others saw multinational corporations and international banks as tools of Western imperialism, attempting to continue by economic means the dominance that the colonial powers had been forced to give up. In the early 1970s, the LDCs came together in international forums to demand a New International Economic Order, a reformed international capitalism that served their interests more directly.

Developing-country demands for a reform of international capitalism were largely ignored by the rich nations. Meanwhile, the semi-autarkic policies of the LDCs began to show signs of serious strains. In the early 1980s, a debt crisis hit even the more advanced developing countries and revealed some of the real weaknesses of ISI – in particular, the difficulties countries pursuing ISI faced in stimulating exports in times of difficulty. Over the course of the 1980s, virtually all LDCs jettisoned their previous hostility to exports, to world trade, and to international investment, and came to adopt

much more open economic models. The developing-country rejection of Western-style capitalism was largely dead.

*Rejectionists: The Soviet bloc.* If developing countries were somewhat skeptical about the desirability of global capitalism, the Soviet Union and its allies – including newly Communist China – were decidedly hostile. The Soviet-led socialist camp was now much larger – including Eastern and Central Europe, China, and increasing numbers of allies in the developing world. And its members denounced capitalism both on principle and in practice. Although the Chinese regime split from the Soviets in the early 1960s, it too embraced a powerful rejection of capitalism.

The Soviet bloc turned to central planning, which attempted to replace the market with strategies devised by the government. Prices were largely divorced from considerations of relative scarcity, and used primarily for accounting purposes. Resources were allocated centrally, or at least by economic ministries and regions that reported to the central government. Essential consumption goods were significantly underpriced, which made for constant shortages of them. “Luxury” goods, such as electronics and automobiles, were either unavailable or severely rationed. Investment, especially in heavy industry, was favored over expansion of the production of consumer goods. In the Soviet Union and China, in particular, military needs were given priority.

The centrally planned economies achieved rapid growth in the twenty years after World War Two, as they drew underutilized resources into production. But Soviet-style planning had many limitations. As was true of the import-substituting economies, the Soviet bloc found that it increasingly needed imports – not only of food, but of technology and precision parts – that it lacked the hard currency to buy. Collectivized agriculture proved massively inefficient, forcing the formerly grain-exporting USSR to expend scarce foreign currency, year after year, on imported cereals. Recurrent campaigns to increase manufactured exports, particularly from the bloc's most advanced economies (e.g., East Germany), brought little success. Only the bloc's raw materials and a few artisanal products found ready purchasers in the West. The absence of incentives gave workers and managers little need to monitor quality, or to innovate either in the production process or with new products. Over time, the industrial plant fell farther and farther behind the technological and quality criteria prevailing in the West, and by the 1980s growth had slowed dramatically. With Western Europe within easy reach of people in the Soviet bloc's Central and Eastern European nations, it was easy for citizens to see the relative failure of the system.

In 1979, the Chinese and Vietnamese regimes both dropped many of their commitments to planning and endorsed movement toward a market economy, including openness to the rest of the (capitalist) world economy. The Soviet Union and its allies attempted a gradual movement toward economic reform, but after 1989 their

governments effectively collapsed, and were replaced by new rulers who largely turned toward global capitalism. Some of the former component parts of the Soviet Union remain reluctant about the capitalist world economy (Belarus and Turkmenistan, for example), as do a few Soviet-style regimes in the developing world (Cuba, North Korea). But by the early 1990s, central planning as an organized, feasible alternative to Western capitalism was of only historical interest.

*Globalization: "The Washington Consensus."* While the Communist economies stagnated, their capitalist rivals experienced new bursts of innovation, productivity, and growth. The 1971 demise of the Bretton Woods system signaled also the developed world's abandonment of capital controls, which in any event had come to be widely evaded. Cross-border investment flourished, and the larger and more mobile pool of world capital both encouraged greater risk-taking and, by allowing production to shift easily to other jurisdictions, eroded trade-union power. In the U.S., deregulation of such ossified sectors as telecommunications, trucking, and airlines stimulated competition, lowered prices, and increased capacity.

At the same time, capitalist economies experienced a spate of innovations that, to contemporary eyes, seemed lifted from science fiction: lasers, fiber optics, microprocessors that packed first thousands, then millions, now billions of transistors

onto a single chip,<sup>51</sup> personal computers, the internet, genetic engineering – and, more mundane but perhaps even more important, containerized shipping.<sup>52</sup> Productivity of labor, land, and intellect all skyrocketed, aided by the far greater global specialization that cheaper communication and transportation made possible.

As in the nineteenth century, this “second globalization” opened enticing new markets for countries and regions. Chile, Argentina, Mexico, Brazil; Indonesia, Malaysia, China, India; almost all of the former Soviet bloc; and, most recently, rapidly growing parts of Africa – all abandoned earlier paths of import substitution or central planning, now to take their places in the new and ever-changing global division of labor. The combination of opening to trade, specialization, foreign investment, and new technology often produced economic growth that far surpassed what the “first globalization” had achieved. China, the stellar example, saw its GDP per capita grow consistently over thirty years by 8-10 per cent annually, thus doubling on average every eight years and increasing 10 to 15-fold over the interval from 1980 to 2010 -- something like four times the rate of growth achieved by Germany or Japan in the Nineteenth Century.

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<sup>51</sup> This was the basis of “Moore’s Law,” according to which the price of computing power is halved roughly every eighteen months.

<sup>52</sup> Levinson 2006.

And this globalization, like its predecessor, generated and sustained its own orthodoxy: no longer the gold standard, but the “Washington consensus,”<sup>53</sup> a distillation of what the International Monetary Fund, the World Bank, the U.S. Treasury, and developed-world bankers and officials more generally saw as the magic formula for economic growth. The “consensus” prescriptions involved openness to trade and investment, secure property rights, fiscal balance (public debt only to finance productive investment, e.g., in infrastructure), a realistic (perhaps even undervalued) exchange rate, public spending chiefly on investments in human and physical capital, moderate marginal tax rates, privatization of state enterprises, and abolition of stifling regulation (e.g., what Indians called the “permit raj”).

As with the gold standard a century earlier, the “consensus” rapidly won the endorsement of elites around the globe. Also as before, some countries adopted mildly heretical versions of the creed: China maintained strict capital controls and massively undervalued its currency, many of the “Asian tigers” protected infant industries, almost everywhere intellectual property remained insecure and agriculture was regarded as a

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<sup>53</sup> The term was coined in 1989 by the economist John Williamson but subsequently developed a somewhat different, and broader, meaning than Williamson had intended. More pejorative terms like “golden straitjacket” and “neoliberalism” are roughly equivalent.

“special case,” coddled in some cases (Korea) but exploited in others (Argentina, much of Africa).

Often enough, the new orthodoxy achieved remarkable success, most notably in some of the former ISI or Communist states (Brazil, Chile, most of Eastern Europe), while sometimes the “magic” failed or encountered insuperable resistance (Russia under Yeltsin, Mexico in the early years of NAFTA). The failures, like fallen soufflés, invited frenzied inquiries by the leading chefs: were the cultures incorrigibly anti-capitalist, were the governments or their subjects recalcitrantly authoritarian or corrupt, had there been (as one quip about Russia had it) “too much shock, and too little therapy?” Or even (*sotto voce*) might the “consensus” somehow be mistaken – not, of course, in its main thrust, but in one or another unforeseen detail?

Finally, and again in close parallel with the earlier orthodoxy of the gold standard, the “consensus” spawned zealots: in this case, believers in perfectly efficient markets, perfectly rational actors, deregulation that compromised even prudential supervision of banks or elementary guarantees of public safety. The market could only shower blessings on mankind: there would be rapid and sustained growth, corrupt markets would be shunned in favor of honest ones, earnings exactly equal to marginal product, and – above all – an accurate pricing and allocation of risk, hence a hitherto

unknown smoothing of markets. In short, no surprises, no bubbles, no slumps.<sup>54</sup> This time, indeed, was different.<sup>55</sup> Except that it wasn't.

*Globalization and its discontents: The crisis of 2007-* . Just as globalization appeared triumphant, disaster struck. In 2007 the U.S. economy ran into trouble. After several years of growth and a particularly striking expansion in real estate and asset markets, housing prices began to fall. This led to distress in an important segment of the country's financial system, the market for mortgage-backed securities and their derivatives. Eventually the weakness spread to the entire American financial system, causing the modern equivalent of a massive system-wide bank run, and it was transmitted immediately to the rest of the world. In early October 2008, it appeared that the whole capitalist world was on the brink of a massive financial collapse, as markets froze in ways not seen since the 1930s and not imagined by the new orthodoxy.<sup>56</sup> As the

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<sup>54</sup> That theoretical macroeconomists embraced such beliefs need not have occasioned worry. Unfortunately, among the most fervent adherents of this ultra-orthodox sect was Federal Reserve Chairman Alan Greenspan. Hence Greenspan took no action to deflate the asset bubble (indeed, dismissed the possibility that one existed).

<sup>55</sup> Reinhart and Rogoff 2009.

<sup>56</sup> Famously, Greenspan confessed later in public testimony that he had regarded the events with "shocked disbelief."

impact of the financial crisis reverberated throughout the global economy, a Great Recession hit.<sup>57</sup>

In most industrial countries, the Great Recession was longer and deeper than any experienced since the 1930s, and recovery was slower and more halting. Europe, in fact, slid into a second recession in 2012. The problem was a familiar one: dozens of countries had accumulated massive debts, including foreign debts, that could not now be serviced as contracted. This was in fact the consequence of a strange but historically familiar pattern that emerged after 2000, in which one large group of countries came to depend upon foreign financing to fuel their economies, while another large group of countries came to depend on exports as the engine of their economic growth.<sup>58</sup> The first group, those that embarked on a debt-financed consumption boom, included the United States, United Kingdom, as well as countries on the periphery of the European Union (Ireland, Spain, Portugal, Greece, much of Central Europe, the Baltic states). The second group, those whose growth was driven by exports (and lending to the consuming countries), included countries in Northern Europe, East Asia, and the oil-producing nations. After several years of increasingly feverish borrowing and asset price growth, the merry-go-round stopped with a crash in fall of 2008.

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<sup>57</sup> For a summary, see Chinn and Frieden 2011.

<sup>58</sup> There was an eerie parallel to the 1920s, when the U.S. was the lending nation and postwar Europe (especially Germany) was the borrower.

As recovery lagged and unemployment reached, and stayed at, levels not seen for decades, dissatisfaction spread at this particular turn of events. As the more serious economic problems were in the OECD, most of the political conflict was there as well. On the Right, the long crisis inflamed sentiment against immigration, and in some quarters against components of the welfare state. On the Left, the crisis provoked another round of objections to increasing inequality, and to the alleged inadequacies of government regulation of business and finance. Virtually every government in office in one of the major debtor nations at the time of the crisis was turned out, and in some cases (Greece, Italy) entire political systems were thrown into disarray.

In the aftermath of the crisis, world capitalism once again faces difficult macroeconomic and distributional issues. As there have always been, there will continue to be debates over how best to stimulate and encourage economic recovery and growth. There will continue to be conflict over who should be asked to sacrifice to restore some vigor to economies that have become stagnant. And there will continue to be heated disagreements over the appropriate role of the government in modern capitalist economies.

### **Conclusions**

The downturn that began in 2007, severe as it was, simply reminds us of the two enduring realities of modern capitalism that provoke antagonism to the system: it is prone to recurring crises; and it is associated with a substantial gap between rich and

poor. Almost everyone would agree that the benefits of a market economy outweigh the costs of its volatility and of the inequality it can breed. But there is massive disagreement over how significant both the volatility, and the inequality, are, as compared to the creative destruction associated with the capitalist economic order. And there is just as much disagreement over how aggressive governments should be in attempting to address both the cyclical fluctuations, and the income inequality, that characterize capitalism.

These issues have been present since capitalism first arose as an integrated economic order in early modern Europe. Some, whether as utopian socialists or Soviet-style Communists, want the state to intervene massively to dampen both fluctuations and inequality – at the expense of capitalism’s ability to increase productivity and generate economic expansion. Others, from state capitalists to fascists, also want the state to intervene, albeit not so much to reduce inequality as to squelch dissent and compel investment. Orthodox enthusiasts of modern capitalism express confidence that the system can, and will, largely look after itself. Wherever the truth may lie, there seems little doubt that so long as capitalism is with us, so too will be conflict over whether it should be preserved, and if so, how.

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